



Missouri Division of Finance

UPDATE

A Report of Missouri State Chartered Financial Institutions

Issue 03-01

June 2003

From . . .
Commissioner
D. Eric McClure

It is our privilege to again bring you this UPDATE from your Missouri Division of Finance. Our banking industry is strong and healthy despite a challenged economy. Total assets in our 299 Missouri state chartered banks continue to grow and recently passed a major milestone of \$50 billion. While we continue to have a small number of banks with problems, for the most part, our banks are safe and sound and have very high capital levels, good reserves, solid earnings and no pronounced asset quality problems. The management teams in our banks are commended for their continued solid performance in spite of these stressed economic times.

The Legislature has been very busy this year struggling with the State budget, however, legislation has been passed and signed that will bring some regulatory relief to our banks. These legislative changes, as well as several new regulations which will soon go into effect, are outlined elsewhere in this UPDATE.

We are proud to announce another significant reduction in the average assessment rate for the coming year. This year's average assessment rate of \$.116 per \$1,000 in assets compares favorably to the 1998 rate of .199, showing a decline of 42 percent over the past six fiscal years. Last year's average assessment rate was \$.125.

It was our pleasure to meet with many of you this Spring during our Outreach meetings held around the State. We had over 300 bankers attend these meetings which were held in Kansas City, St. Louis, Springfield, Sikeston, and Jefferson City. We value the opportunity to hear from you and we plan to schedule another round of meetings in 2004. We like to believe that one of the primary advantages of a State charter is our accessibility. Please never hesitate to contact our office when you have a particular need or drop in for a visit when you are in Jefferson City.

GENERAL USURY

Section 408.030 provides that the Director of Finance shall declare the quarterly market rate of interest each quarter, post it in accordance with Section 361.110 and publish it in appropriate publications. Said quarterly market rate for the period July 1, 2003 through September 30, 2003 shall be 7.4%; as an alternative, 10% may be used.

In This Issue:

- Worksheet
- Legislative Update
- Changes in Regulations
- New Titling Laws
- Banking Performance

Information Technology Examinations



A key risk for financial institutions is the potential disruption of data and other information processed by computer which is critical to management decision making or financial controls. Regulatory agencies refer to this as “*transaction risk*”.

To assess this exposure, examiners routinely conduct *Information Technology (IT) Examinations* in conjunction with safety and soundness examinations. The scope includes in-house applications, if any, and those provided by independent vendors. Bank management must provide for an appropriate control environment to safeguard the integrity of records. Weak points in the information technology system increase the risk that the accuracy of records may be jeopardized. Several common exceptions our examiners identify in the IT area are:

- ✍ *Audit Coverage* - Financial institutions should have strong internal IT audit programs augmented by periodic external audits. A common exception identified in IT examinations is the lack of a formal information technology audit program. Many times, procedures are in place but documentation is not maintained. On other occasions, there is a complete lack of effective audit procedures. Boards of directors should ensure that an effective, independent audit program is in place.
- ✍ *Wire Transfer* - Another frequent area of IT exceptions is wire transfer procedures. It is not uncommon for wire transfer controls to be such that one individual has the potential to perpetrate serious fraud. Examiners often find that controls allow one individual to transmit large funds transfers without appropriate checks and balances. Internal review procedures for wire transactions are also weak in some instances, which could allow improper activity to remain undetected for an extended period of time. Procedures must ensure that no one individual has too broad authority over the wire transfer function. Separation of duties is critical to prevent the potential for serious problems in this area.

These are just two common areas of examiner criticism as a result of IT reviews. Boards of directors are encouraged to refer to the FFIEC Information Systems Handbook for guidance to help ensure proper procedures are followed in the IT department. That handbook, which is in the process of being updated, is available on the FFIEC's web site at www.ffiec.gov and the FDIC's web site at www.fdic.gov. You may also contact Senior Examiner Jerry Janes in our Jefferson City office for assistance.

WORKSHEET

CALCULATION OF UNIMPAIRED CAPITAL AND LEGAL LOAN LIMIT, FOR BANKS WITH GOODWILL

Section 362.170 was amended during the 2003 session of the General Assembly so that goodwill would be treated differently for purposes of determining unimpaired capital and the bank's legal loan limit. The pertinent language is **Goodwill may not comprise more than ten percent of the bank's unimpaired capital.** The following worksheet will assist you in making the legal loan limit calculation. All references to RC pertain to the bank's most recent Report of Condition.

Item 1	Total Equity Capital (from RC-line 28)	
Item 2	Less: Accumulated Other Comprehensive Income (from RC-line 26b) if positive	-
OR		
Item 3	Plus: Accumulated Other Comprehensive Income (from RC-line 26b) if negative	+
Item 4	Plus: Subordinated Notes (from RC-line 19)	+
Item 5	Plus: Allowance for Loan Losses (from RC-line 4c)	+
Subtotal Unimpaired Capital		
Item 6	Less: Goodwill (from RC-line 10a)	-
Item 7	Net unimpaired capital (Subtotal Unimpaired Capital Minus Item 6)	
Item 8	Item 7 divided by .9	
Item 9	Item 8 minus Item 7	
Item 9a	Enter lesser of Item 6 or Item 9	
Item 10	Item 7 plus Item 9a	
<p>This number is the unimpaired capital amount you will use, multiplied by 25, 20 or 15 percent, depending on the condition and location of your bank, to obtain your legal loan limit.</p>		

Note: This worksheet is not necessary if goodwill does not comprise 10% or more of unimpaired capital.

LEGISLATIVE UPDATE

The 2003 session of the Missouri General Assembly saw passage of two bills of direct interest to bankers. HB221 has been signed by the Governor and will be effective August 28, 2003, however, SB346 has not yet been signed by the Governor at the time of this writing, but will be effective August 28, 2003, if approved.

HB221 contains a number of sections which are only of marginal interest to bankers...those items directly related to financial institutions are:

- + the Commissioner is allowed to gather Report of Condition information from existing federal resources thereby eliminating the need to also file these reports with our office;
- + the Commissioner is allowed access to CPA work papers;
- + Section 362.105 is amended to allow banks to purchase real estate for banking purposes, in a value up to the bank's legal loan limit, without approval by the Commissioner (at present this is available only to banks with total assets exceeding \$200,000,000);
- + sections limiting the NSF and OD fees on checks are repealed and replaced by a new section 362.111 allowing the Commissioner to issue a regulation setting such limits, but requiring that these limits be at least equal to what is permitted by the OCC (there is no limit for national banks at this time);
- + Section 362.170 is amended to change the definition of unimpaired capital and limits goodwill to no more than 10 percent of unimpaired capital for purposes of calculating the legal loan limit;
- + a new entity, the trust holding company, is authorized and the Commissioner is given jurisdiction over such trust holding companies; and
- + 408.450-408.470, the variable rate law is repealed.

SB346 contains all of the provisions of HB221 and, in addition:

- + allows the Commissioner to issue biennial consumer credit licenses and
- + increases the delinquency charges and NSF check handling fees for consumer credit loans and 2nd deed of trust loans.

The full text of these bills is available, online at www.house.state.mo.us/

CHANGES IN REGULATIONS:

The Division of Finance has completed the steps necessary to amend its banking regulations. Changes which will take effect August 30, 2003 are as follows:

4 CSR 140-2.055 Purchase of Key-Man Insurance has been substantially changed as the new title, Purchase of Bank-Owned Life Insurance, suggests. In addition to addressing key-person insurance the rule is updated to address insurance on borrowers, insurance offered as an employee benefit including split dollar arrangements, and insurance programs to fund or offset the costs of employee benefit programs. Under this rule, bank-owned life insurance must be supported by the bank's

insurable interest in the lives covered. Purchases must be from sound companies and their financial condition periodically monitored. The cash surrender values of policies placed with a particular insurance company must not be in excess of the bank's legal loan limit.

4 CSR 140- 2.140 Preservation of Books and Records has been amended to make it clear that banks' records may be preserved by means of electronic storage.

The full text of the changes may be found on pages 319-320 of the February 18, 2003 Missouri Register (28 MOREG 319-320).

NEW TITLING LAWS

from Titling Tips, a quarterly publication of the Missouri Department of Revenue

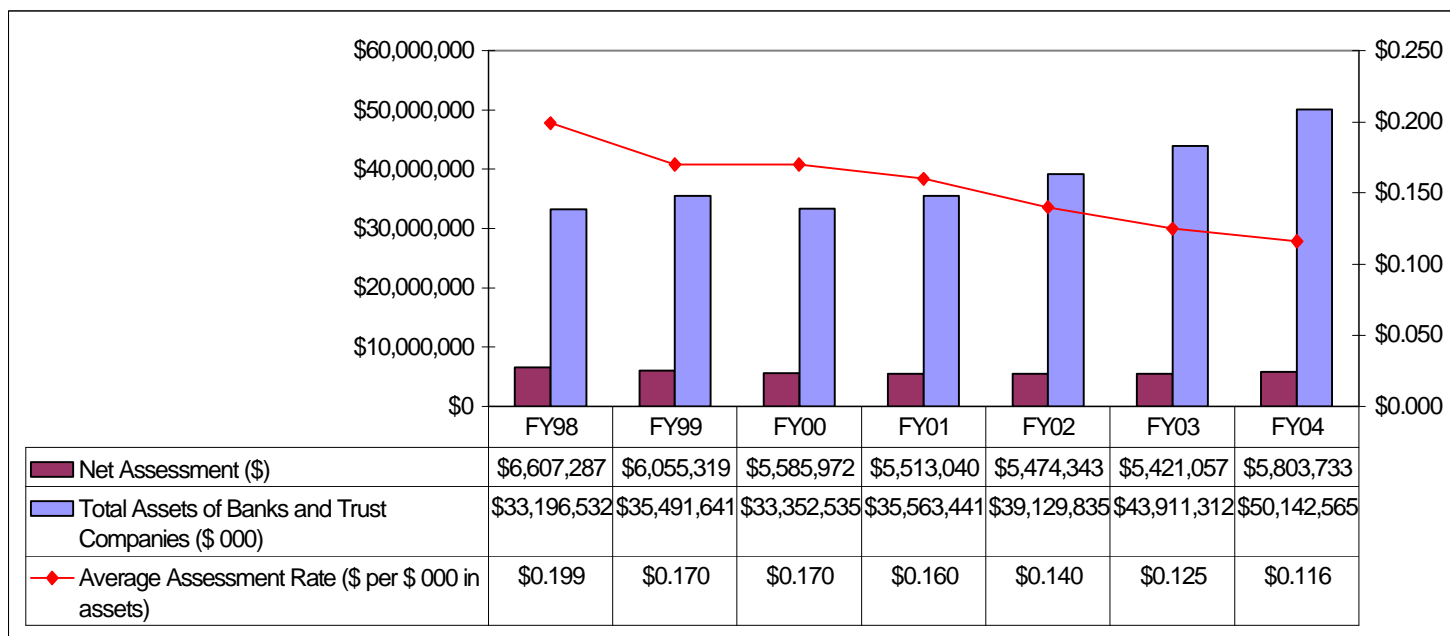
These changes, approved by the 2002 session of the General Assembly will take effect on July 1, 2003 (see HB1196, HB2008 and SB 895).

The major change is that **all titles issued on and after July 1, 2003 (including those for motor vehicles, watercraft and manufactured homes) will be mailed to the owner even if there is a lien thereon.**

HOWEVER:

- ++ The owner **MAY** designate an alternate address on the "Mail-To" section of the title, and that alternate address can be the lien holder's.
- ++ Titles issued prior to July 1, 2003 should be retained by the lien holder until paid off. No action is required.
- ++ Liens released on or after July 1, 2003 must be released on a separate, notarized document **even though the lien was created before July 1, 2003.**
- ++ The lien release area will no longer appear on titles issued on and after July 1, 2003.
- ++ Liens released on and after July 1, 2003 must be released on the new Notice of Lien or Lien Release form (DOR-4809) or on the lien holder's letterhead and in either case, the release must be notarized. (Liens on out-of-state titles may still be released on the face of the title and must be notarized only if the issuing state requires it.)

DIVISION OF FINANCE ANNUAL BANK ASSESSMENT



Missouri Enacts Uniform Securities Act

By: Doug Ommen, Commissioner of Securities

Secretary of State Matt Blunt, who oversees the administration of Missouri securities laws, has announced that the Missouri Securities Act of 2003 ("2003 Act") will become effective on September 1, 2003. The 2003 Act is modeled after the Uniform Securities Act of 2002, approved by the National Conference of Commissioners on Uniform State Laws in 2002. The Commissioner of Securities, Doug Ommen, who was appointed by Secretary Blunt, administers the Missouri securities laws.

The 2003 Act modernizes Missouri securities laws by taking into account recent federal legislation such as the National Securities Markets Improvement Act of 1996 ("NSMIA") and the Gramm-Leach-Bliley Act adopted in 1999 ("GLBA"). The 2003 Act was adopted to promote uniformity among state securities laws and harmony between Missouri and federal law with the functional regulation established in GLBA.

In general, the 2003 Act follows the federal approach in the definition of "broker-dealer." Prior to the adoption of the GLBA, since their securities activity was limited, banks had a complete exception from the definition of the terms "broker" and "dealer" under the Securities Exchange Act of 1934 (the "Exchange Act"). The GLBA replaced this full exception with functional exceptions by amending the definitions of these terms. To stay within the exception, banks must either limit their securities activities to those that fit within the functional exceptions, or conduct the securities activities through a registered broker-dealer.

Banks, savings institutions and trust companies had a complete exception from the definition of "broker-dealer" under current Missouri securities law. The 2003 Act replaces this full exception with functional exceptions for banks, trust companies organized under the law of Missouri, and savings institutions ("Banks") patterned on the provisions of the GLBA. The 2003 Act provides an exception from the definition of broker-dealer for Banks limiting their securities activities to those activities specified in subsections 3(a)(4)(B)(i) to (vi), (viii) to (x), and (xi) if limited to unsolicited transactions; 3(a)(5)(B); and 3(a)(5)(C) of the Exchange Act.

Banks, savings associations, and savings banks have asked for additional time to assess their broker-dealer activities and to determine how best to comply with the new regulatory scheme. The U.S. Securities & Exchange Commission ("SEC") has ordered a temporary exemption for banks, savings associations and savings banks from the definition of the term "dealer" under the Exchange Act until September 30, 2003. The Commissioner of Securities will issue a similar order exempting Banks from the definition of "broker-dealer" under the 2003 Act. This order will take effect on September 1, 2003 and will remain in effect until December 31, 2003.

The Commissioner of Securities also intends to provide two interpretive opinions related to the 2003 Act to the Missouri Bankers Association. One of the interpretive opinions would involve whether loan participations between banks would constitute the offer or sale of a security under the 2003 Act. The second interpretive opinion would involve confirmation of the exclusion of banks and bank employees from the definition of investment adviser under the 2003 Act.

The Commissioner of Securities also intends to propose this summer a rule that involves the networking arrangements between Banks and broker-dealers. As mentioned above, the definition of "broker-dealer" in the 2003 Act provides an exception for Banks that limit their securities activities to many of those activities also specified in federal law. The functional exceptions include Banks involved in appropriate networking arrangements with broker-dealers. The proposed rule will be consistent with federal law and will clarify the conditions for the exception for networking arrangements.

Missouri banks and savings institutions involved in securities activities with questions about compliance with federal and state securities laws, may call the Division of Securities at (573) 751-4136.

Faced With Disaster - Your Recovery Plan Has To Work



The Y2K threat and 9/11 terrorists attack brought to the forefront the need for disaster business resumption plans. In Missouri, the deadly tornados of May 4, 2003, caused widespread damage and made disaster recovery a first hand experience for several local bankers who had to put their contingency plans into action. The storm is considered the third-worst in U.S. history in terms of property damage. Severe weather caused the temporary closing of ten offices of state-chartered banks during the week of May 5th. Some of the hardest hit were branches located in Pierce City and Stockton. Despite the devastation, customer service was maintained with little loss to bank records or customer property. The banks attributed their successful recovery to prior planning, hard work of employees, and the spirit of teamwork and caring by employees, vendors, and the community.

After the storm cells tore through southwest Missouri on Sunday evening, First State of Purdy President Ann Hall discovered four of the bank's five offices, including the main bank, were without utilities and phone service. The Pierce City branch was severely damaged by a tornado, along with the rest of downtown. She also learned a bank employee's husband perished in the storm. Hall advises, "Never think it won't happen to you."

With the aid of a generator, one office opened Monday morning; two more opened Tuesday when utilities were reactivated. At Pierce City, limited customer availability to safe deposit boxes was allowed Tuesday. Expanded services were restored a week after the storm. President Hall credits the bank's successful recovery to all employees following the written disaster recovery plan. As luck would have it, the bank recently conducted a practice run of the recovery plan under a mock bomb threat scenario. She strongly recommends dress rehearsals.

"While we did the technical things right to bring services up, the most challenging issue was performing these tasks while being somewhat shell-shocked and the high emotions from witnessing the destruction," stated Hall. She also stresses "back-up, back-up, back-up" of computer tapes and off-site storage in a secure vault. Ironically, the back-up storage site for the main bank at Purdy was the Pierce City branch, but the tapes remained unharmed in the vault.

As the twisters pushed through the Stockton area, branches of Mid-Missouri Bank and Great Southern Bank were totally destroyed, and the branch of Liberty Bank was damaged. The branch of Liberty Bank closed Monday but reopened Tuesday morning with the aid of an electric generator. Cell phone communication with the bank's other branches allowed employees of the Stockton branch to provide essential services. Due to the building's uncertain structural condition, employees greeted customers on the sidewalk in front of the bank. Executive Vice President Garry Robinson noted, "For the first couple of days, our biggest job was reassuring customers that their records and safe deposit boxes were intact, and assisting them to find answers to questions regarding insurance and disaster relief." Liberty Bank also made arrangements with banks in neighboring towns to allow its customers to cash checks. Robinson offered the following recommendations for disaster planning: make sure important documents are stored in the vault each night, always have access to an electric generator, and have step-by-step recovery procedures that all employees know.

After the Sunday night tornado, the vault was the only thing still standing at Mid-Missouri Bank's Stockton branch. Although closed Monday, by noon Tuesday the branch was operating in a modular unit with an electric generator, replacement computers, and cell phones. Chairman Lee Gilbert attributes the

quick recovery to the bank's written plan and the teamwork of employees, vendors, townspeople and law enforcement. "The key to our recovery plan was having a predetermined hierarchy of people listed to assume leadership of the recovery effort. If the first person on the list is not immediately available, the next one steps up and manages the recovery until finished," related Gilbert. This is important because people you may assume would play a leadership role might not be available because their families have emergencies. A major concern of customers was the contents of their safe deposit boxes. The safe deposit boxes were moved to the modular units and nearby branches. Customer concerns were promptly alleviated when they could see their valuables were not damaged. Gilbert suggests any disaster plan include instructions for prompt collection of records, including computer hard-drives, and on-site security. He also urges that standby supplies include powerful two-way radios to supplement weak cell phone signals, and replacement computers.

At the Great Southern Bank branch in Stockton, the building was destroyed and a battery operated clock was the only piece of equipment operational. By Monday afternoon, a mobile branch was established and conducting business. After the damage assessment, locating a mobile office ready to go, and providing electricity, drinking water, and toilet facilities were the immediate challenges. Vice President Larry Larimore related, "One of the first priorities was making contact with all employees to check their well being." Several people lost their homes or suffered heavy damage. They needed the support of the bank to help get their lives back in order, and understandably, could not participate in recovery efforts. Great Southern has an employee relief fund which provided assistance. Larimore credits the bank's business resumption contingency plan for the incredible recovery. "We actually practice and test drill the plan once a year," noted Larimore. Included in the recovery supplies are packets of bank forms and documents needed to immediately restore a branch. "This was a tremendous help." Additional advice Larimore

offers is that bank managers should thoroughly consider how operations will run when you are off-line. Also consider making a standing arrangement to have a mobile office immediately available upon request.

Several of the bankers urged planning for the ability to gain initial access to the damaged site. Safety hazards, debris, lack of lighting, and weather are inhibiting factors. Law enforcement agencies quickly blocked entrance to the affected areas for safety and to prevent looting. It can be difficult and frustrating for employees to get through unless they have good identification that verifies their association with the bank.

Experience is often the best teacher, although the lessons are the hardest. The success of these bankers drives home several points.

- ✍ It can happen to you!
- ✍ The importance of a well thought-out recovery plan, not just stored in a desk drawer, but one that everyone is familiar with, has been practiced, and you are confident can be activated.
- ✍ Key employees may not be available to lead or assist the recovery effort.
- ✍ Normal communication channels, phone and electronic, will be disrupted. Consider alternatives in the event of weak cell phone signals and your ability to transact business in an off-line environment.
- ✍ Back-up, back-up, back-up. Store back-up data off-site in a secure vault. Keep back-up equipment on hand or have arrangements to acquire it in a hurry.



BANKING PERFORMANCE

Missouri state-chartered banks have again exhibited substantial growth. As of March 31, 2003, 299 state chartered banks held \$50.1 billion in assets and \$41.1 billion in deposits. These totals represent growth rates of 15.7 and 14.5 percent, respectively, since March 31, 2002 when 306 banks held assets and deposits of \$43.4 billion and \$35.9 billion, respectively. A significant portion of the growth came from the merger of an out-of-state bank into a Missouri state-chartered bank. This merger accounted for approximately \$3 billion of the asset growth during the past year. During the preceding twelve months, eight banks left the state banking system through mergers or consolidation. One new bank was chartered.

Selected performance measurements of Missouri state chartered banks include:

	Missouri State Banks			
	3/31/2003	3/31/2002	12/31/2002	12/31/2001
Yield on Earning Assets	5.76	6.50	5.93	7.22
Cost of Funding Earning Assets	1.88	2.62	2.23	3.54
Net Interest Margin	3.88	3.88	3.70	3.68
Loan Loss Provision to Average Assets	0.25	0.24	0.26	0.29
Return on Assets	1.16	1.15	1.09	1.05
Net Charge-offs to Loans	0.04	0.03	0.28	0.32
Non Performing Loans to Total Loans	2.36	1.70	2.03	2.42
Tangible Equity Capital to Assets	8.90	8.71	8.87	8.69
Loans to Assets	68.45	68.49	68.35	68.64
Earning Assets to Total Assets	92.02	93.14	92.06	92.66

Missouri state-chartered banks continue to be in good condition. Only five banks failed to be profitable during the first quarter of 2003. Overall earnings performance remains good and improvement in the net interest margin and return on assets is noted since year-end 2002. The number of problem banks remains low. As of March 31, 2003, nine Missouri state-chartered banks were considered "problem banks" due to their composite CAMELS ratings being a 3 or 4.